Supreme Court, U.S.
FILED

961491 MAR 17 1997

OFFICE OF THE CLERK

No. _____

In The

Supreme Court of the United States

October Term, 1996

JOSEPH CUSIMANO,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

PETITION FOR WRIT OF CERTIORARI

MATTHIAS A. LYDON
Counsel of Record for Petitioner
WINSTON & STRAWN
35 West Wacker Drive
Chicago, Illinois 60601
(312) 558-5600

ANTHONY DISARRO
STEVEN S. OH
WINSTON & STRAWN
200 Park Avenue
New York, New York 10166
(212) 294-6700

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

49 pp

QUESTIONS PRESENTED

1. Can the "misappropriation theory," a judicial creation which does not appear in the language of any statute, constitute a proper basis for establishing criminal liability under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5?[1]

2. Under what circumstances, if any, can a *prediction* or *opinion* – which is unsupported by any facts, and no more specific than the numerous press reports on the topic – form the basis of an insider trading violation under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5?

3. Did the court of appeals misapply the materiality test set forth by this Court in *Basic v. Levinson*, 485 U.S. 224 (1988), when it deemed that a prediction by an insider of an acquisition, which was unsupported by any facts, and no more specific than the numerous press reports on the topic, was "material," "nonpublic" information?

---

[1] This precise issue – namely, the validity of the misappropriation theory – was presented in *United States v. O'Hagan*, No. 96-842, a case in which this Court recently granted certiorari.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

OPINIONS BELOW 1

JURISDICTION 1

STATUTES INVOLVED IN THIS CASE 2

STATEMENT OF THE CASE 3

REASONS FOR GRANTING THE WRIT 8

I. ONE OF THE ISSUES PRESENT IN THIS CASE, NAMELY, THE VALIDITY OF THE MISAPPROPRIATION THEORY, IS AN ISSUE PRESENTED IN *UNITED STATES v. O'HAGAN*, A CASE IN WHICH THIS COURT RECENTLY GRANTED CERTIORARI 9

II. THE COURT OF APPEALS HAS MISAPPLIED SUPREME COURT PRECEDENT IN *BASIC v. LEVINSON* BY FINDING A VIOLATION OF SECTION 10(b) FOR TRADING ON A PREDICTION WHICH WAS UNSUPPORTED BY MATERIAL FACTS, AND NO MORE SPECIFIC THAN WHAT WAS ALREADY REPORTED IN THE PRESS 10

CONCLUSION 17

APPENDIX ..... App. 1

TABLE OF AUTHORITIES

Page

CASES

Basic, Inc. v. Levinson, 485 U.S. 224 (1988) 10, 13, 14, 15, 16

Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994) 10, 15

Chiarella v. United States, 445 U.S. 222 (1980) 11

Dirks v. SEC, 463 U.S. 646 (1983) 11

TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976) 15, 16

Virginia Bankshares Inc. v. Sandberg, 501 U.S. 1083 (1991) 10

STATUTES

15 U.S.C. § 78j(b) 2, 3

17 C.F.R. 240.10b-5 ..... 2, 3

PETITION FOR WRIT OF CERTIORARI

Joseph Cusimano ("Cusimano") respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit which gives rise to this petition is unpublished by the order of the Second Circuit. It is reprinted in Appendix A hereto ("App. A") at App. 1.[2] By order filed December 17, 1996, the Second Circuit denied the petition for rehearing and suggestion for rehearing en banc. App B. The order and judgment of the district court in this case are attached as Appendix C and D, respectively.

JURISDICTION

On October 20, 1995, the District Court for the Southern District of New York entered a memorandum order concluding that Cusimano's relevant conduct for sentencing purposes included all of his trading in the securities of NCR Corporation ("NCR"). Cusimano timely appealed to the Second Circuit, which affirmed in an opinion filed

[2] Citations to "App. ___" refer to the appendix attached to this petition. Citations to "JA ___" refer to the Joint Appendix used in the appeal to the Second Circuit.

on October 4, 1996. On December 17, 1996, the Second Circuit denied Cusimano's timely-filed motion for rehearing and suggestion for rehearing en banc. Pursuant to Supreme Court Rule 13.1, this petition has been filed within 90 days of the denial of rehearing.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED IN THIS CASE

1. Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. 78j, states, in pertinent part:

It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2. Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5 (1983), provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of

interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

Petitioner Joseph Cusimano pleaded guilty to conspiracy to violate Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. 240.10b-5, in connection with certain purchases of NCR securities he made in November, 1990. Petitioner Cusimano admitted conspiring with Charles Brumfield, an employee of AT&T, the corporation which eventually acquired the stock of NCR, to trade NCR securities after receiving material nonpublic information known to have been misappropriated by Brumfield. Nevertheless, petitioner denied conspiring to violate the securities laws with respect to all the NCR securities he purchased in November, 1990; in particular, he denied that any purchases prior to November 14, 1990, were made while he was in

possession of any material nonpublic information misappropriated from AT&T. The significance of petitioner's denial was the substantial impact on the sentence imposed pursuant to the federal sentencing guidelines because the profit from the contested trades was $642,888. Petitioner contended that everything he knew about the possible acquisition of NCR by AT&T, prior to November 14, 1990, as related by Brumfield to him, was either publicly disclosed to him in the *Wall Street Journal* and other public sources, or amounted to insignificant, immaterial opinions of Brumfield. The District Court ruled after an adversarial hearing that the contested trades would be included in calculating the fine and offense level, and a divided panel of the Court of Appeals for the Second Circuit, in an expansive interpretation of the misappropriation theory, affirmed, differing over whether the information relayed by Brumfield to Cusimano was both material and nonpublic.

The Wall Street Journal Article

On November 8, 1990, on the front page, *The Wall Street Journal* reported that "AT&T and NCR are discussing combining their computer businesses, *people familiar with the talks say*" (JA 124) (emphasis added). The *Journal* reported that:

> *individuals familiar with the talks* said the two companies have been holding discussions for more than a month and have explored several scenarios, including an AT&T acquisition of NCR and a spinoff of AT&T's computer business to NCR, with AT&T taking an equity stake in the combined operation.

> The first scenario seems more likely because AT&T has long coveted NCR. It drew up a detailed takeover study of the company almost two years ago.
>
> AT&T found NCR to be a good fit not only culturally but from a product standpoint, according to sources familiar with the study.

(JA 127-8) (emphasis added).

The *Journal* article projected that a takeover was "more likely" and that AT&T would have to pay approximately $85-$90 per share to acquire NCR:

> NCR won't come cheap. If NCR sells for just one times revenue – a reasonably common measure – AT&T would have to fork over more than $6 billion, which was NCR's revenue last year. That would be nearly twice NCR's current market value of $3.22 billion, based on its 67 million shares outstanding and yesterday's closing stock price of $48. . . . (*Id.*)

Interestingly, the factual premise for the *Journal* article's conclusion that it was likely that AT&T would attempt to acquire NCR – *i.e.*, the existence of ongoing discussions between AT&T and NCR regarding a potential transaction – was untrue. According to later public filings by AT&T with the Securities and Exchange Commission ("SEC"), there were no discussions ongoing at that time between NCR and AT&T:

> On November 8, 1990, the Wall Street Journal published an article reporting *erroneous* rumors to the effect that AT&T and the Company [NCR] were then engaged in discussions regarding a possible combination of their computer business (JA 658) (emphasis added).

Indeed, Preston Granbury, AT&T's General Counsel, represented in a letter to the SEC that the erroneous report in the *Journal* actually caused AT&T to "accelerate" its consideration of an acquisition of NCR:

> In response to a November 8 article in the Wall Street Journal reporting erroneous rumors of discussions between AT&T and NCR, it was decided to accelerate consideration of an NCR acquisition (JA 629).

More importantly, as of November 8th, AT&T had not decided whether it would attempt to acquire NCR. As Blaine Davis, AT&T's vice-president of corporate strategy and development, testified:

> On November 7th, we were informed that the Wall Street Journal was going to announce – going to publish a rumor that next day that NCR and AT&T had been engaged in merger discussions. That was done on November 8th. We made our standard reply to that, "We never comment on rumors," and continued on, very aggressively now, to come to a conclusion. *We had not come to a conclusion at that time that we were in fact going to acquire NCR*, but we were pushing very hard (JA 191) (emphasis added).

According to Davis, it was not until November 14, 1990 – when AT&T's Board of Directors authorized management to attempt an acquisition of NCR – that a decision was made and acquisition plans were adopted:

> In the middle of November, a presentation was given to the AT&T board of directors that made the recommendation that we, in fact, acquire NCR at a certain price in a certain way. . . .

> The board of directors said, proceed. From November 15th, roughly, to the first part of December, a number of interactions between Af&T, Bob Allen, the chief executive officer of AT&T, and the chief executive officer of NCR were made (JA 192).

In addition to prompting AT&T to accelerate its consideration of a potential acquisition, the *Journal* article triggered a flurry of public commentary by analysts on the likelihood of an AT&T/NCR merger. Merrill Lynch opined that the report in the *Journal* "on the possible involvement of AT&T and NCR in the computer business could have substance" (JA 134-5). Fahnestock & Co. commented that "a complete merger of NCR into AT&T makes more sense [than other alternatives] because of Telephone's ongoing effort to acquire a substantial presence in the computer industry" (JA 139). In *The Reuter Business Report*, an analyst was quoted as saying "NCR makes sense [for AT&T]. These are two companies that happen to have the same strategy and products that are essentially compatible" (JA 131).[3]

Brumfield's Information to Cusimano

On the same day of *The Wall Street Journal* article, Charles Brumfield, a vice president of labor relations at

---

[3] *See also* The Associated Press, Nov. 8, 1990 (citing reports of ongoing discussions and stating "that there have been reports for several years that the phone company was interested in acquiring a computer company") (JA 132); The First Boston Corporation, Nov. 8, 1990 (discussing "reports that [AT&T] is combining its computer operation with NCR" and noting that "AT&T has been down this road before.") (JA 136-38)

AT&T, called his friend Joseph Cusimano. As the majority of the Second Circuit Panel stated the facts,

> "Brumfield had come to believe that AT&T was going to acquire NCR based on information he obtained through the course of his employment. (Brumfield had conducted a feasibility study relating to the merger of AT&T with an unnamed company that had the same vital statistics as NCR. Moreover, Brumfield's supervisor, William Ketchum, had brought the *Journal* article to his attention that morning and, although he did not usually give such warnings, had expressly cautioned Brumfield not to discuss it). Brumfield therefore told Cusimano that he believed that the contents of the newspaper article were true, and that 'AT&T was going to be attempting to acquire NCR.' "

Nothing more was known or communicated by Brumfield.

Although the district court suggested that Brumfield was an "insider" or, alternatively, that he obtained information "from insiders at AT&T" (JA 825), Brumfield conceded that he was not an insider with respect to AT&T's consideration of acquiring NCR and that "no one individual at AT&T had told me that we were going to buy NCR" (JA 417).

REASONS FOR GRANTING THE PETITION

I. ONE OF THE ISSUES PRESENT IN THIS CASE, NAMELY, THE VALIDITY OF THE MISAPPROPRIATION THEORY, IS AN ISSUE PRESENTED IN *UNITED STATES v. O'HAGAN*, A CASE IN WHICH THIS COURT RECENTLY GRANTED CERTIORARI.

The Court has granted certiorari in *United States v. O'Hagan*, No. 96-842, to consider among other things, whether trading of securities on material, nonpublic information misappropriated in breach of fiduciary duties owed to an acquiring party to a tender offer violated Section 10(b) of the Securities Exchange Act of 1934. Like O'Hagan, this petitioner was found to have engaged in deceit in connection with a securities transaction when he purchased from someone to whom he owed no fiduciary duty, while he was in possession of information misappropriated from someone to whom he did owe a fiduciary duty. The harm to the victim of the breach was wholly intangible and separate from the securities transaction. Indeed, the tangible, financial consequences were suffered by the seller in the securities transaction to whom no fiduciary duty was owed, and to whom the market principle of *caveat emptor* applied. The present petition raises the identical issue, and accordingly ought to be held for disposition as appropriate in light of the decision in *O'Hagan*.

Even if *O'Hagan* is reversed on this issue, the present petition affords an opportunity to the Court to set the metes and bounds of the misappropriation theory to ensure that not every securities trade made in contravention of ethical responsibilities by persons with greater

access to information regarding a potential transaction is deemed a violation of Section 10(b). The Court has required more in *Basic v. Levinson*, 485 U.S. 224 (1988), on materiality of information, and ought to provide further guidance in this case even if the Court deems in *O'Hagan* that Section 10(b) bans trading on any informational advantage obtained by unlawful means.

II. THE COURT OF APPEALS HAS MISAPPLIED SUPREME COURT PRECEDENT SET FORTH IN *BASIC v. LEVINSON* BY FINDING A VIOLATION OF SECTION 10(b) FOR TRADING ON A PREDICTION WHICH WAS UNSUPPORTED BY MATERIAL FACTS, AND NO MORE SPECIFIC THAN WHAT WAS ALREADY REPORTED IN THE PRESS.

This case involves a statement of prediction, not one of fact. Section 10(b) and Rule 10b-5 promulgated thereunder prohibit deception and fraud, in the form of a misrepresentation or omission of a material fact, in connection with the purchase or sale of a security. *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 114 S.Ct. 1439, 1448 (1994). Although the Rule references the word "fact," courts outside the insider trading context have concluded that opinions, predictions and projections can be materially false and misleading, and thus actionable under Section 10(b) or Rule 10b-5, if they are made without a reasonable basis. *Cf. Virginia Bankshares Inc.* v. *Sandberg*, 501 U.S. 1083 (1991). In the area of insider trading, however, the Supreme Court has never

addressed whether and under what circumstances a prediction could form the basis of an insider trading conviction.[4]

Attempting to navigate through these uncharted waters, all three Circuit Judges in this case recognized that it would be "extreme" to hold that any predictions made by an insider can constitute the basis for insider trading simply because a tippee relied upon them and their source, and they subsequently came true. (App. 6, 12).

The majority remarked that a prediction could form the basis of an insider trading violation where the prediction is credibly supported. (App. 6). Dissenting Judge Meskill stated the rule in the converse: "Predictions that [are] based on false or thoroughly inconclusive information" cannot be the subject of an insider trading offense. (App. 11).

Rejecting the government's contentions, the majority stated that Brumfield had "no real basis" to predict that "AT&T *would* acquire NCR." (App. 6) (emphasis in original). This is not surprising since Brumfield was not privy to any information from NCR's management or its shareholders, and the success of any acquisition attempt by AT&T would depend upon either (a) an agreement by

---

[4] It is clear, however, that an individual may lawfully use his superior financial or expert analysis, or his educated guesses or predictions, or his past practices or experience to determine what stocks to purchase or sell. Moreover, the idea that the antifraud provisions require equal information among all traders was rejected. *Dirks v. SEC*, 463 U.S. 646, 658 (1983); *Chiarella v. United States*, 445 U.S. 222 (1980).

NCR's management to merge with AT&T; or (b) a majority of NCR's shareholders tendering their shares to AT&T. Instead, the majority viewed Brumfield's prediction as more "qualified": "that he *believed* that what he had read in the [*Journal*] was true, and that AT&T was going to be *attempting* to acquire NCR." *Id.* (emphasis in original). Stating that Brumfield had "private information to support both these remarks" the majority concluded that the prediction could be the predicate of a criminal insider trading violation. *Id.* This "private information" consisted of (1) Brumfield being asked to conduct a study of a potential work force integration between AT&T and a company similar to NCR, and (2) Brumfield being warned by his supervisor not to speculate about the *Journal* article. (App. 5-6).

The majority's conclusion is terribly flawed. First, the fact that Brumfield had been asked to study the labor relations consequences of a potential work force integration between AT&T and a company similar to NCR did not make it more likely that an *acquisition* would occur, as opposed to the other option mentioned in the *Journal* article – *i.e.*, a "spinoff of AT&T's computer business to NCR, with AT&T taking an equity stake in the combined operation." (JA 127). In fact, the undertaking of such a study did not make it more likely that *any* type of AT&T/NCR merger would occur. Significantly, the *Journal* article noted that, two years ago, AT&T had conducted a "detailed takeover study" of NCR and "had found NCR to be a good fit not only culturally but from a product standpoint." (JA 127-28). That study did not prompt AT&T to attempt to acquire NCR in 1988 and, thus, there

is no reason to believe that Brumfield's work force integration project would prompt AT&T to attempt an acquisition in November 1990. Thus, the majority's analysis that the project "would make a reasonable investor less likely to believe that 'nothing' would happen" is simply wrong. (App. 6).

Second, Brumfield's prediction was not supported by the fact that his supervisor had "warned Brumfield not to speculate with others about the article" and that "Ketchum was not wont to give Brumfield such warnings." (App. 5-6). The Court in *Basic* rejected the notion that a corporation's refusal to comment on acquisition rumors are an indication of the truth of those rumors:

> It has been suggested that given current market practices, a "no comment" statement is tantamount to an admission that merger discussions are underway. That may well hold true to the extent that issuers adopt a policy of truthfully denying merger rumors when no discussions are underway, and of issuing "no comment" statements when they are in the midst of negotiations. *There are, of course, other statement policies firms could adopt . . .*

485 U.S. at 239 n.17 (citations omitted; emphasis added); *see also id.* at 249 ("We also reject the proposition that information becomes material by virtue of a public statement denying it"). Moreover, there is clear and uncontested evidence in the record that AT&T's standard practice was *never* to comment on rumors of acquisitions in the press. (JA 186). Although the majority noted that Brumfield claimed that Ketchum "did not usually give such warnings" to Brumfield (App. 3), that fact indicates

nothing about the likelihood of an acquisition attempt. Ketchum undoubtedly cautioned Brumfield on this occasion because Ketchum knew that Brumfield would be meeting with union officials who would likely voice concerns regarding a potential combination between AT&T and a notorious non-Union company, such as NCR. (JA 405).

In short, Brumfield possessed no information that would credibly support his belief that "what was in the [*Journal*] was "true." (JA 416). Nor did Brumfield possess any information that would support the prediction that AT&T was going to attempt to acquire NCR. No one at AT&T told Brumfield that AT&T would seek to acquire NCR and Brumfield never learned of any acquisition plan from any AT&T documents. As is evident from even the majority's description of that article, the principal thrust of the *Journal* article was that "AT&T and NCR were discussing ways to integrate their business." (App. 3). Brumfield had no knowledge of whether discussions had, in fact, taken place. Indeed, uncontroverted evidence in the record, including AT&T's filings with, and communications to, the SEC, as well as the trial testimony of Blaine Davis, the Government's only witness on this topic, indicates that AT&T was not engaged in any discussions with NCR at that time. (JA 191, 629, 658-68).

This Court has required more to establish probability in measuring the materiality of information in *Basic*, and should reiterate that standard in the context of insider trading in order that those persons with greater privy to useful market information is appropriately guided.

Dissenting Judge Meskill's fear regarding the potential adverse consequences of the majority decision is well founded. In view of the absence of any other authority regarding whether and under what circumstances a prediction could form the basis of an insider trading conviction, other courts may indeed "hold that any prediction made by an insider can constitute the basis for insider trading simply because a tippee relies upon them and their source, and they subsequently come true". (App. 12) As this Court emphasized in *Central Bank*, the securities markets "demand certainty and predictability." 114 S.Ct. at 1454.

This case involved information regarding a subject that had been discussed widely in the press – a proposed transaction involving AT&T and NCR. An analysis of the element of materiality is fairly straightforward when the subject matter of the purported inside information is nonpublic. The court simply determines whether there is a substantial likelihood that a reasonable shareholder would consider the matter important in deciding whether to purchase or sell shares. *See Basic*, (adopting in Section 10(b) action materiality test for proxy materials developed in *TSC, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976)). When the subject concerns a merger or acquisition, the Court should assess both "indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of company activity." *Basic*, 485 U.S. at 238.

When, however, as here, the information relates to a matter which has already been discussed in the press, an additional analytical step is required. The court must examine whether there is a substantial likelihood that the

additional information would reasonably be viewed as significantly altering the "total mix" of available information. *Id.* at 231-32 (quoting *Northway*, 426 U.S. at 449). With respect to contingent events, such as a possible acquisition, courts must first compare the additional information with that already existing in the public domain to determine whether that additional information indicates a sufficiently higher level of probability that the transaction will or will not occur.

The court of appeals completely misapplied the probability test. The majority cited to the totality of information within AT&T, instead of the totality of the information possessed by the tipper, Brumfield. Thus, the majority remarked that "[p]rior to November 12, AT&T had hired an investment bank, outside counsel, and accountants to formulate an acquisition plan; AT&T management had conducted integration plans for an acquisition; and AT&T management teams were conducting discussions relating to an NCR bid." (App. 7). The record, however, is clear that Brumfield knew nothing about AT&T's retention of investment bankers, lawyers and accountants, any acquisition plans or any discussions concerning an NCR bid. (JA 401-83) Accordingly, the majority never determined whether the information possessed by Brumfield could reasonably be viewed as significantly altering the total mix of information already available concerning the probability of an AT&T acquisition of NCR.

The ruling of the court of appeals directly conflicts with the materiality standard set forth by this Court in *Basic v. Levinson*. Because the question of materiality in

the context of federal securities laws is an issue of paramount importance, review by the Supreme Court is warranted.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

MATTHIAS A. LYDON
Counsel of Record for Petitioner
WINSTON & STRAWN
35 West Wacker Drive
Chicago, Illinois 60601
(312) 558-5600

ANTHONY DiSARRO
STEVEN S. OH
WINSTON & STRAWN
200 Park Avenue
New York, New York 10166
(212) 294-6700

APPENDIX A

MANDATE

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

GEORGE LANGE III
CLERK

At a Stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 4th day of October, one thousand nine hundred and ninety-six.

PRESENT: HON. Thomas J. Meskill
HON. Guido Calabresi
HON. Fred I. Parker

Circuit Judges

Docket No: 96-1309
(Filed Oct. 4, 1996)

UNITED STATES OF AMERICA,

Appellee,

v

WILLIAM MYLETT, ROBERT ALLEN, ROBERT FLANAGAN, THOMAS FLANAGAN and ALBERT BRODY,

Defendants,

JOSEPH CUSIMANO,

Defendant-Appellant.

Appeal from United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the Southern District of New York and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby **ORDERED, ADJUDGED, and DECREED** that the judgment of said district court be and it hereby is affirmed in accordance with the opinion of this court.

For the Court
GEORGE LANGE III, Clerk
By:
/s/ Beth J. Meador
Beth J. Meador
Administrative Attorney

A TRUE COPY
GEORGE LANGE III, CLERK

/s/ George Lange III

ANTHONY DISARRO Winston & Strawn, New York, N.Y. (Daniel K. Webb, Matthias A. Lydon, on the brief), *for Defendant-Appellant.*

CALABRESI, *Circuit Judge:*

Joseph Cusimano appeals from a final judgment and sentence entered on May 16, 1996, in the United States District Court for the Southern District of New York following his conviction for trading in violation of Rule 10b-5 of the Securities Exchange Act of 1934. 15 U.S.C. § 78n(e); 17 C.F.R. § 240.10b-5 (1988). Cusimano contends that there was insufficient evidence to support a finding

of insider trading, and that the district court erred as a matter of law in finding that he committed perjury. We reject both contentions and affirm the district court.

I. Background

On November 8, 1990, *The Wall Street Journal* stated in an article that, according to unnamed sources, AT&T and NCR Corporation were discussing ways to integrate their businesses. The article indicated that the form that this combination might take was unclear, but it gave an acquisition of NCR by AT&T, and a spinoff of AT&T's computer business to NCR, as possible examples. The article also noted that the *Journal's* sources had cautioned that the talks between the two companies might well come to nothing, since AT&T had repeatedly shown interest in acquiring various computer makers over the past years to no effect.

On the same day, Charles Brumfield, a Vice President of Labor Relations at AT&T, called his friend Joseph Cusimano. Brumfield had come to believe that AT&T was going to acquire NCR based on information he obtained through the course of his employment. (Brumfield had conducted a feasibility study relating to the merger of AT&T with an unnamed company that had the same vital statistics as NCR. Moreover, Brumfield's supervisor, William Ketchum, had brought the *Journal* article to his attention that morning and, although he did not usually give such warnings, had expressly cautioned Brumfield not to discuss it.) Brumfield therefore told Cusimano that he believed that the contents of the newspaper article were true, and that "AT&T was going to be attempting to

acquire NCR." Cusimano thereafter made a series of trades in NCR securities on November 9, November 12, and November 15-20, 1990. AT&T did not publicly announce its friendly offer to acquire NCR until December 2, 1990. On December 3, 1990, the stock of NCR increased $24.75 per share to a closing price of $81.50 per share.

On August 18, 1995, Cusimano pleaded guilty to insider trading for the purchases he made between November 15-20, but not for the trades he had made on November 9 and November 12. On October 20, 1995, the district court issued an opinion and order holding, *inter alia*, that the November 9 and November 12 trades should be included in calculating Cusimano's offense and fine level and that Cusimano's sentence should be further enhanced for perjury. Cusimano appeals. Since his appeal turns on factual findings, we review for clear error. *See United States v. Rivera*, 971 F.2d 876, 892 (2d Cir. 1992) (citation omitted).

II. Discussion

A. *Insider Trading*

Cusimano's first contention is that the district court erred in finding that his trades on November 9 and November 12 constituted insider trading. Under the misappropriation theory of Rule 10b-5, insider trading occurs whenever a person trades while in knowing possession of misappropriated and material non-public information. *See United States v. Chestman*, 947 F.2d 551, 566, 570 (2d Cir. 1991), *cert. denied*, 503 U.S. 1004 (1992). Cusimano maintains that the district court erred in finding (1) that

the information was non-public; (2) that the information was material; (3) that the information was misappropriated; and (4) that he acted with scienter.

1. Non-public Nature of the Information

The district court did not err in its holding that the information imparted by Brumfield to Cusimano was non-public. To constitute non-public information under the act, information must be specific and more private than general rumor. *See SEC v. Monarch Fund,* 608 F.2d 938, 942-43 (1979). While the district court acknowledged that papers such as *The Wall Street Journal* had speculated, on or before November 8, 1990, that AT&T might acquire NCR, it also noted that Brumfield imparted information "that was substantially more specific than that in the newspaper." The court pointed out that while the newspaper reports listed an attempted acquisition as one possibility among many, Brumfield's statement to Cusimano that "AT&T was going to attempt to acquire NCR" was both more specific and more certain than any reports in the press.

The defendant contends that Brumfield's conclusion that an acquisition would occur was not supported by the non-public facts at his disposal. These facts, he argues, could just as easily have supported other conclusions, including the one that "nothing" would happen. We disagree. Brumfield's conclusion was supported, for example, by the non-public facts (1) that he had been asked to do a study of the feasibility of integrating AT&T's workforce with that of a computer company with the same vital statistics as NCR, and (2) that Ketchum warned

Brumfield not to speculate with others about a press report that discussed the possibility that AT&T and NCR might combine (and Ketchum was not wont to give Brumfield such warnings). At the very least, these nonpublic facts would make a reasonable investor less likely to believe that "nothing" would happen. That by itself would be information with significant market value. Moreover, the facts might well have pointed more specifically toward an acquisition than did the general newspaper article to a Vice President of the company, who would know how to place them in their proper context. *Cf. Monarch Fund,* 608 F.2d at 941 ("Because of their positions, insiders know when they have the kind of knowledge that is likely to affect the value of stock.") (citations omitted).

We do not today hold that any predictions made by an insider can constitute the basis for insider trading simply because a tippee relies upon them and their source, and they subsequently come true. It may well be that insider trading has not occurred, for example, in situations in which an insider has made categorical statements that are completely without foundation and these are used successfully by a trader. We need go nowhere near such an extreme holding, for here the statement made by the insider was qualified, supported, and credible. Brumfield did not state that AT&T *would* acquire NCR. He had no real basis for such a statement. He did say, on the basis of nonpublic data, that he *believed* that what he read in the paper was true, and that AT&T was going to be *attempting* to acquire NCR. He had private information that would support both of these remarks,

and both of them were of great value to a would-be trader.

2. Materiality

The trial court did not err in finding that the information imparted by Brumfield was material. When an event is "contingent and speculative," the materiality of information regarding that event depends "upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *Basic, Inc. v. Levinson*, 485 U.S. 224, 238 (1988) (citation and internal quotation marks omitted). The district court held that Brumfield "conveyed information that indicated a much higher level of probability than was publicly available concerning an event of great magnitude in the corporate life of NCR."

The defendant maintains that the district court was wrong about both the probability and the magnitude of the event. He claims that the probability of the merger before November 8 was low because "there is no evidence that, prior to November 12, senior management of AT&T was in favor of an acquisition of NCR." This is belied by the record. Prior to November 12, AT&T had hired an investment bank, outside counsel, and accountants to formulate an acquisition plan; AT&T management had conducted integration plans for an acquisition; and AT&T management teams were conducting discussions relating to an NCR bid. The defendant also avers that the magnitude of the event was not high. He does not show, however, why a $6 billion acquisition should

not be considered an event of great magnitude. He contends instead that magnitude depends not only on the size of the deal but also on whether the market has already internalized the information with respect to the merger at the time of the trade. But even harder under this measure, the sharp jump in NCR's stock price after a formal acquisition announcement was made suffices to support a finding that the event in this case was one of major magnitude.

3. *Misappropriation*

The district court correctly found that Cusimano misappropriated information. Under Rule 10b-5, misappropriation occurs when a person acquires "material nonpublic information in breach of a fiduciary duty or similar relationship of trust and confidence and uses that information in a securities transaction." *Chestman*, 947 F.2d at 566. As shown above, the information in this case was both non-public and material. Therefore, the only additional showing needed to establish misappropriation is that the information was acquired through a breach of a relationship of trust and confidence.

Cusimano acquired his information precisely in this way for he knew that his source, Brumfield, held a position of trust and confidence in AT&T. Defendant nevertheless contends that there was no misappropriation because Brumfield concluded through his own ingenuity that AT&T would acquire NCR. He was never told about the acquisition and did no more than piece together evidence obtained while working for AT&T. In *SEC v. Materia*, 745 F.2d 197, 201 (2d Cir. 1984), *cert. denied*, 471 U.S.

1053 (1985), however, we upheld a trial court's finding of misappropriation where the defendant traded on information that he pieced together through the course of his employment. The defendant's objection therefore must fail.

4. Scienter

Finally, the district court did not err in finding that Cusimano acted with scienter. Rule 10b-5 requires that the defendant subjectively believe that the information received was obtained in breach of a fudiciary duty. *See Chestman*, 947 F.2d at 570. Such belief may, however, be shown by circumstantial evidence. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983). Cusimano knew that he had obtained information from Brumfield. He argues that this does not show scienter because "nothing about Brumfield's position as a labor negotiator would logically give rise to the inference" that he was disclosing inside information. Because Cusimano knew that Brumfield was a Vice President of AT&T, this contention is meritless.

B. ***Obstruction of Justice Through Perjury***

The defendant also appeals the trial court's sentencing enhancement for obstruction of justice through perjury. "A sentence enhancement for perjury is warranted when a defendant testifying under oath gives false testimony concerning a material matter with the willful intent to provide false testimony. . . . " *United States v. Cawley*, 48 F.3d 90, 94 (2d Cir. 1995) (citation and internal

quotation marks omitted). Any ambiguity regarding the testimony must be evaluated in the light most favorable to the defendant. *See United States v. Cunavelis*, 969 F.2d 1419, 1423 (2d Cir. 1992). But such an enhancement is mandatory once its factual predicates have been established. *United States v. Friedman*, 998 F.2d 53, 58 (2d Cir. 1993). The trial court found that Cusimano lied in order to cover up the fact that he traded on inside information. This determination is supported by uncontested findings, such as the fact that Cusimano stated that his November 12 trades were inspired by a TV show that he watched at lunchtime, while the record shows that his trades began early that morning. Defendant contends that even if he lied, those lies did not concern a material matter. That contention is without merit. If Cusimano's false testimony had been credited, it would have provided an alternative explanation for his trades. This in turn would have cast doubt on whether he knowingly acted on inside information, which is a required element of insider trading. Defendant's lies thus were clearly material.

III. Conclusion

Because Cusimano traded on November 9 and 12 while in knowing possession of misappropriated and material non-public information, the district court correctly found that he engaged in insider trading on those two dates. Moreover, because Cusimano willfully gave false testimony about a material matter under oath, the court did not err in enhancing his sentence for obstruction of justice through perjury.

We affirm the judgment of the district court.

U.S.A. v. Joseph Cusimano #96-1309

MESKILL, *Circuit Judge,* concurring in part and dissenting in part:

I concur in most of the majority's opinion. However, I cannot agree that Cusimano's trades on November 9 and 12 were criminal acts that should have been included in calculating his offense and fine level.

A person violates Rule 10b-5 when he or she "misappropriates material nonpublic information in breach of a fiduciary duty or similar relationship of trust and confidence and uses that information in a securities transaction." *United States v. Teicher,* 987 F.2d 112, 119 (2d Cir. 1993) (quoting *United States v. Chestman,* 947 F.2d 551, 556 (2d Cir.) (in banc), *cert. denied,* 503 U.S. 1004 (1992), *cert. denied,* 510 U.S. 976 (1993)). Persons who trade while in knowing possession of such information similarly violate Rule 10b-5.

It follows that if none of the information that is allegedly "inside" information meets all of the elements (namely, material and nonpublic), there can be no violation. The flaw in the majority's reasoning on the November 9 and 12 trades, is its attribution of materiality to Brumfield's predictions that were based on false or thoroughly inconclusive information. Thus, I believe, that even though some of the information relayed by Brumfield to Cusimano was material, and some was non-public, none was both. Therefore, I respectfully dissent as to those trades.

The majority's first theory is that Brumfield added to the information already available in the [sic] *Wall Street*

Journal. However, the extra information – that the transaction definitely was going to happen and that it was going to be an acquisition – did not exist at the time Brumfield tipped Cusimano. In other words, Brumfield could not state correctly that the acquisition attempt was going to happen at all, because according to Blaine Davis, the head of AT&T's Strategic Development group, the only government witness on this event, AT&T had not yet made that decision. The exploratory steps taken by AT&T prior to deciding whether to make a bid for NCR were just that, exploratory business inquiries before making an important business decision.

The majority says: "We do not today hold that any predictions made by an insider can constitute the basis for insider trading simply because a tippee relies upon them and their source, and they subsequently come true." I fear that, by implication, they may have done just that.

I would vacate the judgment of conviction as to Cusimano's sentence and remand for resentencing.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

GEORGE LANGE III
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 17th day of December one thousand nine hundred and ninety-six.

USA,

Appellee,

v

Joseph Cusimano,

Defendant-Appellant.

Dkt No: 96-1309

(Filed Dec. 17, 1996)

A petition for rehearing containing a suggestion that the action be *reheard* in banc having been filed herein by the appellant Joseph Cusimano.

> Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED.**

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular active service and to any other judge that heard

the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

GEORGE LANGE III, Clerk

By: /s/ Beth J. Meador
Beth J. Meador,
Administrative Attorney

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------x

UNITED STATES OF AMERICA

- against -

JOSEPH CUSIMANO

Defendant

95 Cr. 105 (JSM)

MEMORANDUM ORDER

----------x

JOHN S. MARTIN, JR., District Judge:

Presently before the Court is the question of whether the profits that plaintiff made in transactions involving the securities of NCR Corporation should be included in calculating his offense level under the Sentencing Guidelines. Defendant denies that he possessed material nonpublic information improperly obtained from AT&T employees at the time he engaged in these transactions. Defendant's assertion involves both legal and factual issues.

First, defendant contends that, even if this Court were to accept the testimony of Charles Brumfield as true, the information Brumfield passed on was neither nonpublic nor material. In essence, defendant claims that Mr. Brumfield communicated to Mr. Cusimano no more than was published in the [sic] *Wall Street Journal* and the *New York Times* on the same day, November 8, 1990. A comparison of the newspaper articles that day and Mr. Brumfield's testimony shows, however, that Mr. Brumfield imparted information that was substantially more

specific than that in the newspapers and that this information was highly material.

Brumfield testified that he told Cusimano "that AT&T was going to be attempting to acquire NCR Corporation" and he wanted Cusimano to buy NCR options for him. Both the [sic] *Wall Street Journal* and the *New York Times* articles reported only that the two companies were discussing various scenarios for combining their computer businesses. Obviously, a decision of the two companies to somehow combine their computer operations would not be as likely to cause a rise in the price of NCR stock as would an acquisition by AT&T. Moreover, Brumfield's assertion that AT&T was going to be attempting the acquisition was much more certain than the rumored possible acquisition reported in the press. Indeed, the *Times* quoted an analyst as saying, "I'd put the odds now at 40% of it actually happening." There can be no doubt that the analyst would have raised the odds considerably if he had been privy to the Brumfield-Cusimano conversation.

In *Basic, Inc. v. Levinson*, 485 U.S. 224, 238 (1988), the Supreme Court quoted with approval the Second Circuit's statement in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied, Coates v. SEC*, 394 U.S. 976 (1969), that materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." Here, Brumfield conveyed information that indicated a much higher level of probability than was publicly available concerning an event of great magnitude in the corporate life of NCR.

Thus, what Brumfield told Cusimano was highly material, as is confirmed by Cusimano's action in risking almost $60,000 by purchasing NCR options the following day. It cannot be doubted that any investor would want to know that insiders at AT&T were saying that an acquisition was going to take place.

Although the defendant challenges the testimony of Brumfield that he made the statements to Cusimano, the Court credits the testimony of Brumfield and finds as a fact that those conversations did take place and that in substance his testimony reflects what occurred between them on November 8th. This factual finding rests both on the Court's assessment of Mr. Brumfield's credibility and on the logic flowing from Cusimano's actions the following day. Cusimano admits that he talked to Brumfield on November 8th and there is no reason to believe that Brumfield would not have passed on the information he possessed. Moreover, the following day, beginning the first thing in the morning, Cusimano invested almost $100,000 in NCR securities, including almost $60,000 in options, substantially more than he had ever invested in options before. It is apparent from his actions that he made this investment because he knew he had obtained from Brumfield material inside information. Brumfield's testimony also establishes that Cusimano knew that this information came from insiders at AT&T who had no right to disclose it.

In sum, the Court concludes that Cusimano's relevant conduct for sentencing purposes includes all of his trading in NCR securities.

SO ORDERED.

Dated: New York, New York
October 20, 1995

/s/ John S. Martin, Jr.
JOHN S. MARTIN, JR., U.S.D.J.

copies to:

Karen Patton Seymour
Michael E. Gertzman
Assistant United States Attorneys
Southern District of New York
1 St. Andrew's Plaza
New York, NY 10007

Dan K. Webb
Matthias A. Lydon
Winston & Strawn
35 West Wacker Drive
Chicago, IL 60601-9703

Gregg B. Reisman
Winston & Strawn
175 Water Street
New York, NY 10038

APPENDIX D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA

vs.

Joseph Cusimano
(Defendant's Name)

JUDGMENT IN A CRIMINAL CASE
(For Offenses Committed On or After November 1, 1987)

Case Number:
95 cr 00105-01 JSM

Matthias A. Lydon, Esq.
Attorney's Name

THE DEFENDANT:

x pleaded guilty to count(s) 1.
___ was found guilty on count(s) _____ after a plea of not guilty.

Accordingly, the defendant is adjudged guilty of such count(s), which involve the following offenses:

TITLE SECTION
18 USC 371

NATURE OF OFFENSE
Conspiracy to commit Securities Fraud

DATE OF OFFENSE
2/9/95

COUNTS
1

The defendant is sentenced as provided in pages 2 through 5 of this judgment. The sentence is imposed pursuant to the Sentencing Reform Act of 1984,

___ The defendant has been found not guilty on counts _____ and is discharged as to such count(s).

x Count(s) All open counts (is)(are) dismissed on the motion of the United States.

x It is ordered that the defendant shall pay a special assessment of $ 50.00, for count(s) 1, which shall be due x immediately ___ as follows:

IT IS FURTHER ORDERED that the defendant shall notify the United States attorney for this district within 30 days of any change of name, residence, or mailing address until all fines, restitution, costs, and special assessments imposed by this judgment are fully paid.

Defendant's Soc. Sec. No.: 338-44-8808

Defendant's Date of Birth: 1/17/50

Defendant's Address: 608 Timberline Drive Joliet, Illinois 60431

May 3, 1996
Date of Imposition of Sentence

/s/ John S. Martin, Jr.
Signature of Judicial Officer
John S. Martin, Jr., U.S.D.J.

DATE: 5/13/96

Certified True Copy by: Linda M. Thomas
Deputy Clerk

DEFENDANT: Joseph Cusimano
CASE NUMBER: 95 cr 00105-01 JSM

IMPRISONMENT

The defendant is hereby committed to the custody of the United States Bureau of Prisons to be imprisoned for a term of TWENTY-ONE (21) MONTHS ON COUNT 1.

x The court makes the following recommendations to the Bureau of Prisons:

The court recommends that the defendant be placed in a minimum security facility as close to his home as possible.

___ The defendant is remanded to the custody of the United States marshal.

___ The defendant shall surrender to the United States marshal for this district,

___ at ____ a.m. on _____.
___ as notified by the United States Marshal.

x The defendant shall surrender for service of sentence at the institution designated by the Bureau of Prisons,

x before 2:00 p.m. on June 3, 1996 .

___ as notified by the United States marshal.

___ as notified by the probation office.

RETURN

I have executed this judgment as follows:

_____

_____

____ Defendant delivered on ____ to _____, with a certified copy of this judgment.

_____
United States Marshal

By _____
Deputy Marshal

SUPERVISED RELEASE

Upon release from imprisonment, the defendant shall be on supervised release for a term of THREE YEARS.

While on supervised release, the defendant shall not commit another federal, state, or local crime and shall not illegally possess a controlled substance. The defendant shall comply with the standard conditions that have been adopted by this court (set forth below). If this judgment imposes a restitution obligation, it shall be a conditions [sic] of supervised release that the defendant pay any such restitution that remains unpaid at the commencement of the term of supervised release. The defendant shall comply with the following additional conditions:

_x_ The defendant shall report in person to the probation office in the district to which the defendant is released within 72 hours of release from the custody of the Bureau of Prisons.

_x_ The defendant shall pay any fines that remain unpaid at the commencement of the term of supervised release.

_x_ The Defendant shall not possess a firearm or destructive device.

The defendant is to pay a fine in the amount of $1,000,000 on or before June 3, 1996.

The defendant is to provide the Probation Department access to any requested financial information.

The defendant is not to incur any new lines of credit without the approval of the Probation Department.

STANDARD CONDITIONS OF SUPERVISION

While the defendant is on supervised release pursuant to this judgment, the defendant shall not commit another federal, state or local crime. In addition:

1) the defendant shall not leave the judicial district without the permission of the court or probation officer;

2) the defendant shall report to the probation officer as directed by the court or probation officer and shall submit a truthful and complete written report within the first five days of each month;

3) the defendant shall answer truthfully all inquiries by the probation officer and follow the instructions of the probation officer;

4) the defendant shall support his or her dependents and meet other family responsibilities;

5) the defendant shall work regularly at a lawful occupation unless excused by the probation officer for schooling, training, or other acceptable reasons;

6) the defendant shall notify the probation officer with [sic] 72 hours of any change in residence or employment;

7) the defendant shall refrain from excessive use of alcohol and shall not purchase, possess, use, distribute, or administer any narcotic or other controlled substance, or any paraphernalia related to such substances, except as prescribed by a physician;

8) the defendant shall not frequent places where controlled substances are illegally sold, used, distributed, or administered;

9) the defendant shall not associate with any persons engaged in criminal activity, and shall not associate with any person convicted of a felony unless granted permission ot [sic] do so by the probation officer;

10) the defendant shall permit a probation officer to visit him or her at any time at home or elsewhere and shall permit confiscation of any contraband observed in plain view by the probation officer;

11) the defendant shall notify the probation officer within seventy-two hours of being arrest [sic] or questioned by a law enforcement officer;

12) the defendant shall not enter into any agreement to act as an informer or a special agent of a law enforcement agency without the permission of the court;

13) as directed by the probation officer, the defendant shall notify third parties of risks that may be occasioned by the defendant's criminal record or personal history of characteristics, and shall permit the probation officer to make such notifications and to confirm the defendant's compliance with such notification requirements.

FINE

The defendant shall pay a fine of $ 1,000,000 . The fine includes any costs of incarceration and/or supervision.

x This amount is the total of the fines imposed on individual counts as follows:

Count 1

___ The court has determined that the defendant does not have the ability to pay interest. It is ordered that:

___ The interest requirement is waived.
___ The interest requirement is modified as follows:

This fine plus any interest required shall be paid:

___ in full immediately.
x in full not later than June 3, 1996 .

___ in equal monthly installments over a period of ___ months. The first payment is due on the date of this judgment. Subsequent payments are due monthly thereafter.

___ in installments according to the following schedule of payments:

If the fine is not paid, the court may sentence the defendant to any sentence which might have been originally imposed. See 18 U.S.A. § 3614.

STATEMENT OF REASONS

___ The court adopts the factual findings and guideline application in the presentence report.

OR

_x_ The court adopts the factual findings and guideline application in the presentence report except (see attachment, if necessary): The Court finds that the defendant did in fact commit perjury, therefore a 2 point enhancement for obstruction of justice was deemed appropriate.

Guideline Range Determined by the Court:

Total Offense Level: 16

Criminal History Category: I

Imprisonment Range: 21 to 27 months

Supervised Release Range: 2 to 3 years

Fine Range: $ 5,000 to $ 1,966,450

___ Fine is waived or is below the guideline range, because of the defendant's inability to pay.

Restitution: $ _____

___ Full restitution is not ordered for the following reason(s):

_x_ The sentence is within the guideline range, that range does not exceed 24 months, and the court finds no reason to depart from the sentence called for by application of the guidelines.

OR

___ The sentence is within the guideline range, that range exceeds 24 months, and the sentence is imposed for the following reasons(s) [sic]:

OR

The sentence departs from the guideline range

___ upon motion of the government, as a result of defendant's substantial assistance.

___ for the following reasons(s) [sic]:

_____

Supreme Court, U.S.
FILED
MAY 21 1997
CLERK

(2)

No. 96-1491

In the Supreme Court of the United States

OCTOBER TERM, 1996

JOSEPH CUSIMANO, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

WALTER DELLINGER
Acting Solicitor General
JOHN C. KEENEY
Acting Assistant Attorney General
JOSEPH C. WYDERKO
Attorney
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

RICHARD H. WALKER
General Counsel
PAUL GONSON
Solicitor
JACOB H. STILLMAN
Associate General Counsel
ERIC SUMMERGRAD
Principal Assistant General Counsel
RANDALL W. QUINN
Senior Litigation Counsel
Securities and Exchange Commission
Washington, D.C. 20549

18 pp

QUESTIONS PRESENTED

1. Whether petitioner's trading in securities on material, nonpublic information received from a corporate employee, who had misappropriated that information in breach of his fiduciary duties to the corporation, violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, and thus constituted insider trading under Sentencing Guidelines § 2F1.2.

2. Whether, in determining petitioner's sentence under Sentencing Guidelines § 2F1.2, relating to insider trading, the courts below correctly found that the information petitioner traded on was both material and nonpublic.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	1
Discussion	10
Conclusion	15

TABLE OF AUTHORITIES

Cases:

Basic Inc. v. *Levinson*, 485 U.S. 224 (1988) 9, 12, 13, 14

TSC Indus., Inc. v. *Northway, Inc.*, 426 U.S. 438 (1976) 12

United States v. *Chestman*, 947 F.2d 551 (2d Cir. 1991), cert. denied, 503 U.S. 1004 (1992) 11

Statutes and regulations:

Securities Exchange Act of 1934, § 10(b), 15 U.S.C. 78j(b) 2, 10, 11

18 U.S.C. 371 2

17 C.F.R. 240.10b-5 (Rule 10b-5) 2, 10

Sentencing Guidelines:

§ 2F1.2 ..... 2, 6, 11

§ 2F1.2(b)(1) 2, 3

§ 3C1.1 10

In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-1491

JOSEPH CUSIMANO, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-12) is reported at 97 F.3d 663. The opinion of the district court (Pet. App. 15-18) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on October 4, 1996. A petition for rehearing was denied on December 17, 1996. Pet. App. 13-14. The petition for a writ of certiorari was filed on March 17, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

After entering a guilty plea in the United States District Court for the Southern District of New

York, petitioner was convicted of conspiracy to violate Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5, in violation of 18 U.S.C. 371. He was sentenced to 21 months' imprisonment, to be followed by three years of supervised release, and was fined $1 million. Pet. App. 19-27. The court of appeals affirmed. *Id.* at 1-12.

1. On August 18, 1995, petitioner pleaded guilty to conspiring with Charles Brumfield and others to violate Section 10(b) of the Exchange Act by trading in the securities of NCR Corporation, Digital Microwave Corporation, and Teradata Corporation while in possession of material, nonpublic information about the proposed acquisitions of those three companies by AT&T Corporation. Brumfield had misappropriated that information from AT&T, where he was a vice president of labor relations. Pet. App. 3; Gov't C.A. Br. 3-5. At the plea hearing, petitioner admitted that he had received material, nonpublic information from Brumfield regarding NCR, Teradata, and Digital Microwave securities. He also admitted that he made purchases in those securities based on the information obtained from Brumfield, and that he gave part of the proceeds of his transactions to Brumfield. Gov't C.A. Br. 4.

2. In the plea agreement, the parties stipulated that petitioner's base offense level was eight under Sentencing Guidelines § 2F1.2, the Guideline relating to insider trading. The parties expressly declined to stipulate to the total gain resulting from the offense, which would determine petitioner's adjusted offense level under Guidelines § 2F1.2(b)(1). Petitioner stipulated that $340,337 in profits that he earned from

purchases of NCR securities between November 15 and 20, 1990, should be included in determining the amount of the gain under Guidelines § 2F1.2(b)(1). Petitioner asserted, however, that an additional $642,888 in profits earned from trading in NCR securities on November 9 and 12, 1990, should not be included in determining the amount of the gain because those trades did not violate the securities laws. Petitioner's principal contention was that the information that he received from Brumfield and used in his trades on November 9 and 12 was neither material nor nonpublic. Pet. App. 4; Gov't C.A. Br. 5-6.

At petitioner's sentencing hearing, the government presented evidence that petitioner traded in NCR securities on November 9 and 12, 1990, after receiving information from Brumfield concerning a proposed acquisition of NCR by AT&T, and that petitioner knew that Brumfield had misappropriated that information. The evidence showed that, in March 1990, AT&T's corporate strategy and development group made a presentation to AT&T's executive management committee concerning a possible acquisition of NCR to strengthen AT&T's position in the computer industry. In August and September 1990, AT&T's investment bank analyzed several acquisition alternatives, including an acquisition of NCR. On October 17, 1990, the alternatives were presented to AT&T's board of directors. That same day, the board of directors selected NCR as the most attractive acquisition candidate and directed that a feasibility study be conducted. Between October 17 and November 7, 1990, AT&T formed several project teams to study the proposed acquisition. The teams included William Ketchum, who was Brumfield's immediate supervisor at AT&T. Gov't C.A. Br. 8-9.

In late September or early October 1990, an executive in AT&T's computer business unit asked Brumfield to evaluate the labor relations issues involved in integrating the workers in his unit with the work force of another computer company. Although the executive did not disclose the other company's name to Brumfield, Brumfield realized, based on the statistics he was provided, that the other company was NCR. Pet. App. 3; Gov't C.A. Br. 9-10.

One week after Brumfield completed his feasibility study, he and Ketchum attended a conference together on November 1 and 2, 1990. On the second day of the conference, Ketchum received a telephone call summoning him back to AT&T's offices for an emergency meeting with the president of AT&T's computer business unit. Ketchum's executive assistant told Brumfield that Ketchum had been called away for the meeting and would not return to the conference. Brumfield believed that the emergency meeting was a highly unusual and significant development, particularly since he had recently completed his feasibility study for the computer business unit but was not invited to attend the meeting. Gov't C.A. Br. 10-11.

On November 8, 1990, Brumfield was in Washington, D.C., to attend a meeting with union members. When Brumfield returned a telephone call to Ketchum that morning, Ketchum asked whether Brumfield had seen that day's *Wall Street Journal*. After Brumfield replied that he had not, Ketchum told him that the newspaper had reported that AT&T and NCR were discussing ways to combine their operations. Ketchum warned Brumfield not to speculate with others about the newspaper article during his meeting later that day. Ketchum's warning was significant to Brumfield because it was the first time

that Ketchum, who had a limited labor relations background, had ever directed Brumfield how to perform his job. Brumfield concluded that Ketchum's warning indicated that the newspaper story was true. Pet. App. 3, 16; Gov't C.A. Br. 11-12.

After speaking with Ketchum, Brumfield called petitioner, whom he had met in 1989 and with whom he had frequently discussed the possibility that AT&T might acquire a computer company. Brumfield discussed the *Wall Street Journal* article with petitioner and advised petitioner to read the article if he had not yet done so. Brumfield told petitioner that he believed that the contents of the article were true, and that AT&T would attempt to acquire NCR. Brumfield asked petitioner to purchase NCR call options for him through petitioner's brokerage account, and petitioner agreed. Brumfield said that he would contact petitioner shortly to tell him which series of call options he wanted to buy. Later that day, Brumfield called co-defendants William Mylett and Robert Allen and provided them with the same information. He also made arrangements with Mylett and Allen to buy NCR call options for him. Pet. App. 3-4; Gov't C.A. Br. 12-14.

The next day, November 9, 1990, Brumfield called petitioner to tell him which NCR call options to buy. He told petitioner to buy the options as soon as possible because he believed that the acquisition would occur quickly. Petitioner did not ask Brumfield for any money with which to purchase the options, and Brumfield did not send him any money. Gov't C.A. Br. 14-15.

That same morning, petitioner began buying NCR call options. By the end of the day, petitioner had purchased more than $52,700 worth of NCR call

options through his own brokerage account. He also purchased $18,000 worth of NCR securities through his brother's brokerage account. On the following Monday, November 12, 1990, petitioner purchased more than $27,900 in NCR call options through his brokerage account and more than $4,400 in NCR call options through his brother's account. Petitioner's purchases on November 12 accounted for more than 80% of the total market purchases for one series of NCR options and 50% of the total market purchases for another series. Later that day, petitioner confirmed with Brumfield that he had purchased the NCR call options that Brumfield had specified. Pet. App. 4; Gov't C.A. Br. 15-16.

After the publication of the *Wall Street Journal* article, AT&T accelerated its plans to acquire NCR, and the board of directors approved the acquisition on November 14, 1990. On December 2, 1990, AT&T publicly announced a tender offer to acquire NCR on a stock-for-stock basis at a price valued at $90 per share of NCR stock. After the announcement, NCR's stock price increased $24.75 per share on Monday, December 3, 1990, to a closing price of $81.50 per share. Pet. App. 4; Gov't C.A. Br. 16. Petitioner earned $642,888 in profits from trading in NCR securities on November 9 and 12, 1990, in his and his brother's accounts. Gov't C.A. Br. 6.

3. The district court ruled that petitioner's trades in NCR securities on November 9 and 12, 1990, constituted insider trading, and therefore were properly included in calculating petitioner's offense level under Guidelines § 2F1.2. Pet. App. 15-17. The court rejected petitioner's claim that those trades did not violate the securities laws because the information conveyed by Brumfield was neither nonpublic nor

material. The court observed that "Mr. Brumfield imparted information that was substantially more specific than that in [*The Wall Street Journal*] and that this information was highly material." *Id.* at 15-16. The court noted that the newspapers had reported only that the two companies "were discussing various scenarios for combining their computer businesses," and that "a decision of the two companies to somehow combine their computer operations would not be as likely to cause a rise in the price of NCR stock as would an acquisition by AT&T." *Id.* at 16. Since "Brumfield conveyed information that indicated a much higher level of probability than was publicly available concerning an event of great magnitude in the corporate life of NCR," the court concluded that "what Brumfield told [petitioner] was highly material," and that "[i]t cannot be doubted that any investor would want to know that insiders at AT&T were saying that an acquisition was going to take place." *Id.* at 16-17. The court further found that petitioner "knew he had obtained from Brumfield material inside information" and "knew that this information came from insiders at AT&T who had no right to disclose it." *Id.* at 17. The court accordingly ruled that petitioner's "relevant conduct for sentencing purposes includes all of his trading in NCR securities." *Ibid.*

4. a. The court of appeals affirmed. Pet. App. 1-12. It first noted that, "[u]nder the misappropriation theory of Rule 10b-5, insider trading occurs whenever a person trades while in knowing possession of misappropriated and material non-public information." *Id.* at 4. It then concluded, contrary to petitioner's submissions, that the district court had not erred in concluding that the information about the NCR acquisition that petitioner traded on was nonpublic,

material, and misappropriated from AT&T, and that petitioner acted with scienter. See *id.* at 4-5.

Concerning the nonpublic nature of the information, the court noted that Brumfield imparted information to petitioner "that was substantially more specific than that in the newspaper." Pet. App. 5. "[W]hile the newspaper reports listed an attempted acquisition as one possibility among many, Brumfield's statement to [petitioner] that 'AT&T was going to attempt to acquire NCR' was both more specific and more certain than any reports in the press." *Ibid.* The court noted further that Brumfield was well positioned to conclude that AT&T would in fact attempt to acquire NCR, because he had been asked to perform the labor relations feasibility study, and Ketchum had warned him not to speculate about the press reports. *Id.* at 5-6.

The court expressly stated that it "[did] not today hold that any predictions made by an insider can constitute the basis for insider trading simply because a tippee relies upon them and their source, and they subsequently come true." Pet. App. 6. The court observed that "here the statement made by the insider was qualified, supported, and credible." *Ibid.* It also explained that "Brumfield did not state that AT&T *would* acquire NCR," but rather, "on the basis of nonpublic data, that he *believed* that what he read in the paper was true, and that AT&T was going to be *attempting* to acquire NCR." *Ibid.* "[Brumfield] had private information that would support both of these remarks, and both of them were of great value to a would-be trader." *Id.* at 6-7.

The court further ruled that "[t]he trial court did not err in finding that the information imparted by Brumfield was material." Pet. App. 7. In reaching

that conclusion, the court expressly applied the test adopted by this Court in *Basic Inc.* v. *Levinson*, 485 U.S. 224, 238 (1988), that the materiality of a contingent and speculative event depends "upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." Pet. App. 7. The court first rejected petitioner's argument that the probability of AT&T's acquisition of NCR was low before his trades occurred. Even before those trades, "AT&T had hired an investment bank, outside counsel, and accountants to formulate an acquisition plan; AT&T management had conducted integration plans for an acquisition; and AT&T management teams were conducting discussions relating to an NCR bid." *Ibid.* The court then rejected petitioner's claim that the magnitude of the event was not high, noting that petitioner had not explained "why a $6 billion acquisition should not be considered an event of great magnitude." *Id.* at 7-8. The court also remarked that "the sharp jump in NCR's stock price after a formal acquisition announcement was made suffices to support a finding that the event in this case was one of major magnitude." *Id.* at 8.

Finally, the court of appeals ruled that "[t]he district court correctly found that [petitioner] misappropriated information." Pet. App. 8. The court explained that petitioner "acquired his information [through a breach of a relationship of trust and confidence] for he knew that his source, Brumfield, held a position of trust and confidence in AT&T," notwithstanding that Brumfield had never been told directly by anyone at AT&T that AT&T was planning to acquire NCR but had "concluded through his own

ingenuity" that the acquisition would be attempted. *Ibid.*[1]

b. Judge Meskill concurred in part and dissented in part. Pet. App. 11-12. He did not agree that petitioner's "trades on November 9 and 12 were criminal acts that should have been included in calculating his offense and fine level." *Id.* at 11. In his view, "even though some of the information relayed by Brumfield to [petitioner] was material, and some was non-public, none was both." *Ibid.* In particular, he concluded that Brumfield's predictions of an acquisition of NCR by AT&T "were based on false or thoroughly inconclusive information" and were therefore not material, *ibid.*, since "Brumfield could not state correctly that the acquisition attempt was going to happen at all," *id.* at 12.

DISCUSSION

1. Petitioner contends (Pet. 9-10) that his conviction for conspiring to commit securities fraud is invalid because the misappropriation theory does not constitute a proper basis for establishing criminal liability under Section 10(b) of the Exchange Act and Rule 10b-5. That issue is currently before the Court in *United States* v. *O'Hagan*, No. 96-842 (argued April 16, 1997). Petitioner therefore requests that the petition in this case be held for *O'Hagan*.

Petitioner pleaded guilty to the charge of conspiracy to violate Section 10(b), aware that the government's theory of liability for the predicate offense of

---

[1] The court of appeals also found that petitioner had acted with scienter. Pet. App. 9. It further rejected his contention that the district court erred in enhancing his offense level for obstruction of justice (through perjury at the sentencing hearing) under Guidelines § 3C1.1. Pet. App. 9-10.

securities fraud was based on the misappropriation theory. Petitioner did not move to withdraw his guilty plea and did not, in the district court or on his initial appeal, challenge the misappropriation theory as a basis for his substantive criminal liability.[2] Both lower courts, however, treated the principal sentencing issue in this case—whether insider trading had been established with regard to petitioner's November 9 and 12, 1990, trades, such that petitioner's gain from those trades should be used to calculate his offense level under Guidelines § 2F1.2—as identical to the question of substantive criminal liability under Section 10(b). Moreover, the court of appeals reaffirmed its precedent that, "[u]nder the misappropriation theory of Rule 10b-5, insider trading occurs whenever a person trades in knowing possession of misappropriated and material non-public information." Pet. App. 4 (citing *United States* v. *Chestman*, 947 F.2d 551, 566, 570 (2d Cir. 1991) (en banc), cert. denied, 503 U.S. 1004 (1992)).

The Court's decision in *O'Hagan* may affect the court of appeals' resolution of the sentencing issue in this case, its treatment of petitioner's substantive criminal liability, or both. Accordingly, the petition in this case should be held for the Court's decision in *O'Hagan*, and then disposed of as appropriate in light of that decision. If the Court in *O'Hagan* upholds the misappropriation theory, the petition should be denied. If the Court rules in *O'Hagan* that the misappropriation theory is not a valid basis for criminal liability under Section 10(b), the court of appeals on

---

[2] In a petition for rehearing presented to the court of appeals, petitioner asked that court to reconsider the validity of the misappropriation doctrine. Pet. C.A. Br. 2.

remand will be free to reconsider the sentencing issues as well as whether petitioner may assert an objection to his substantive criminal liability, notwithstanding his guilty plea and his failure to raise the issue on appeal until the rehearing stage.

2. Petitioner also contends (Pet. 10-17) that the courts below erred in concluding that the information he obtained from Brumfield and used in his trades in NCR securities on November 9 and 12, 1990, was material and nonpublic. The conclusion of the courts below that the tip petitioner received from Brumfield was based on material, nonpublic information is correct. It is also a fact-bound determination, based on a correct application of this Court's materiality test. Further review is therefore not warranted.

Materiality depends on the significance that the "reasonable investor" would place on the relevant information. *Basic Inc.* v. *Levinson*, 485 U.S. 224, 240 (1988). The materiality of information about a contingent or speculative event, such as a potential merger, "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *Id.* at 238. The question of materiality in any particular case is "inherently fact-specific." *Id.* at 236; see also *id.* at 240; *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 450 (1976) (although materiality "may be characterized as a mixed question of law and fact," materiality determination "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact"). All the surrounding facts must be considered to

determine whether certain information is material; no particular event or factor is necessary to render merger discussions material. See *Basic*, 485 U.S. at 239.

The lower courts correctly applied the proper legal standards to the facts of this case. Petitioner argues (Pet. 14, 15) that the tip he received from Brumfield was merely unsupported speculation by a corporate insider, and that the court of appeals' decision will allow prosecution for insider trading whenever someone receives a prediction from an insider that happens to come true. But the court of appeals rejected the proposition that insider-trading liability could be founded on an unsupported prediction, and held that the tip here was supported (Pet. App. 6):

> We do not today hold that any predictions made by an insider can constitute the basis for insider trading simply because a tippee relies upon them and their source, and they subsequently come true. * * * We need go nowhere near such an extreme holding, for here the statement made by the insider was qualified, supported, and credible.

The court of appeals' conclusion that Brumfield's tip was based on material, nonpublic information is correct. Brumfield did more than speculate that AT&T would attempt to acquire NCR; he had substantial information beyond that reported in the *Wall Street Journal* about the possibility of an acquisition of NCR. Brumfield had been asked to conduct a study of the feasibility of integrating AT&T's work force with that of a computer company with the same vital statistics as NCR. Brumfield's supervisor had also taken the unusual step of warning him not to discuss a press report speculating about AT&T and NCR.

Pet. App. 5-6. Furthermore, Brumfield was aware that his supervisor had recently been called to an emergency meeting with the president of AT&T's computer services unit. Gov't C.A. Br. 10-11. Even though no one had told Brumfield directly that AT&T executives were actively pursuing a merger with NCR, Brumfield's access to corporate information obtained in the course of his employment duties enabled him to reach that conclusion.

Brumfield's inside information was material because there was a substantial likelihood it would have been considered significant by a reasonable investor and (had it been disclosed to the market) would have been viewed by such an investor as having significantly altered the "total mix" of available information. *Basic*, 485 U.S. at 231-232. For the information about AT&T's acquisition of NCR to be material, it was not necessary that the acquisition have been certain to take place or have been definitively authorized by the directors of AT&T. As petitioner recognizes, under *Basic*, information about a contingent event such as a possible corporate acquisition can be material even if that event is not certain to occur. The privately expressed view of a corporate insider that an acquisition attempt would be made, supported by knowledge of nonpublic events occurring within AT&T, was more detailed and definite information than could be culled by investors from public sources. And as the court of appeals observed (Pet. App. 7-8), a $6 billion acquisition is "an event of great magnitude," a point confirmed by the "sharp jump" (*id.* at 8) in NCR's stock price after the announcement of the acquisition. The lower courts therefore did not err in concluding that the information used by petitioner in this case was both material and nonpublic.

CONCLUSION

As to the first question presented, the petition for a writ of certiorari should be held pending the Court's decision in *United States* v. *O'Hagan*, No. 96-842, and then disposed of as appropriate in light of the decision in that case. In all other respects, the petition should be denied.

Respectfully submitted.

WALTER DELLINGER
Acting Solicitor General

JOHN C. KEENEY
Acting Assistant Attorney General

JOSEPH C. WYDERKO
Attorney

RICHARD H. WALKER
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

ERIC SUMMERGRAD
Principal Assistant General Counsel

RANDALL W. QUINN
Senior Litigation Counsel
Securities and Exchange Commission

MAY 1997